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Ken Bradstreet
Executive Director

April 6, 1998

TO: **The Honorable John McHugh**
House Government Reform and Oversight Committee
Chairman, Postal Service Subcommittee

FROM: **Kenneth L. Bradstreet, Executive Director**
Association of Alternate Postal Systems

SUBJECT: **Comments on pending postal reform legislation before the House Postal Service Subcommittee.**

I. Biographical Sketch

My name is Kenneth L. Bradstreet. I am the Executive Director of the Association of Alternate Postal Systems (AAPS) and currently the General Manager of Advertisers Postal Service (APS) in Gaylord, Michigan. We appreciate the opportunity to comment on HR22, and greatly appreciate that you and your staff are willing to consider our comments.

APS is a private enterprise delivery system in rural northern Michigan. In addition to private delivery, APS also operates a mailing service, which does mail preparation for various shopping guides, newspapers, and retailers in the area.

I have been involved in Postal Rate Commission and related matters for about fifteen years. In addition to personal participation in four rate cases and a classification case, I have also represented the alternate delivery industry on various panels at a number of conferences and forums. I participated as a speaker at the Cato Institute forum on postal privatization in April 1988. In March 1990, the morning following the filing of R90-1, I appeared opposite Postmaster General Anthony Frank on a morning news show produced by WWOR in the New York City market, and broadcast to cable systems throughout the United States. The segment was a discussion of the 1990 postal rate proposal.

My 21 years of experience as a competitor of the Postal Service, as a mailer, and more recently as president and representative of a trade association of private delivery companies, has given me a great deal of exposure to postal issues, particularly as they affect private delivery companies throughout the country. I consider it essential that competitors of the U.S. Postal Service participate in postal issues.

II. Purpose Of These Comments

Our industry learned in 1981 that we could not afford to sit back and assume that the Postal Service will deal fairly with us. As a result of the 1981 rate decision, the third class rates with which we competed were reduced precipitously, some by as much as 42%, putting many of our number out of business. Since that time, the well being of the alternate delivery industry has been tied more to postal rates than to any other factor.

Our industry competes with the Postal Service for the delivery of advertising material, product samples, directories, and, previously, subscription magazines. Most alternate delivery volume is saturation advertising, formerly Third Class Bulk Regular, and more recently Standard Mail, Enhanced Carrier Route, Saturation.

It is clear to me from participating in several postal rate proceedings and from studying other USPS actions that the Postal Service has engaged in a crusade to attract volumes of saturation advertising away from newspapers and alternate delivery competitors. Part of that effort involves pressing for postal reform in Congress, which would give it greater pricing flexibility. We view any attempt to circumvent Postal Rate Commission review as a serious threat.

It is further my understanding that the proposed legislation would allow the Postal Service to annually reduce the ECR rate with which we compete by 2% per year without PRC review, and irrespective of how its costs are increasing. I believe that such a pricing flexibility would result in the demise of most of our members= alternate delivery operations. Those member companies who have no other profit centers other than alternate delivery would undoubtedly go out of business, and the thousands of jobs they provide would be lost. It is for this reason that I am submitting these comments on the proposed reform legislation.

III. If They Can, They Will

Proponents of the proposed reform, and specifically the pricing flexibility, have posed the question, "What makes you so sure that the Postal Service would lower the rate for ECR saturation by 2% every year?" My answer is simply, based upon fifteen years of involvement in the postal rate arena, "If they can, they will."

For the past fifteen years the US Postal Service has engaged in a virtual crusade against those who compete for the delivery of saturation advertising. This is understandable. First Class volumes are to some degree susceptible to electronic transmission alternatives. And there are really only two major "pots of gold" available to the Postal Service. These two huge revenue sources are First Class mail and Standard A advertising mail.

As much as the USPS may talk about other "competitive" products, like parcel post and express mail, advertising mail by far offers the greatest number of dollars and thus the greatest competitive opportunity. Certainly saturation ECR mail is the most critical volume of mail currently subject to hard-copy competition. The USPS without question, but erroneously, believes that continuing growth in ECR saturation mail is crucial to its well being and its future.

"Shared mail" is advertising mail that mingles several advertising pieces together, either into an envelope or into an outside jacket piece, and which then is entered into the mailstream as a single piece. The participants are each charged a share of the postal rate and other costs, and the mailer who coordinates the program pockets the leftover revenues as profits. Shared mail has become a national phenomenon since the early 1980s. Some of the USPS's largest customers today are shared mailers.

The Postal Service has been very accommodating to these mailers, especially

Advo the largest. Thus, although Advo's motion for special rates for saturation mailers was rejected by the Commission in R84-1, the USPS, true to form, in R90-1 added new discounts for saturation density and for entry location, very similar to Advo's 1984 request. These new discounts allowed the USPS to recommend effective reductions of 10% for all saturation advertising mail in the 1990 case. While the USPS was offering reductions to saturation advertisers, other mailers, including less fortunate third-class mailers (i.e., those with no practical alternative), were getting hammered by sizable increases.

The PRC did not allow the proposed10% reductions, but it did incorporate the new discounts into the third class rate structure at the conclusion of R90-1. At that point, preparation discounts had pretty much reached their logical limit. If shared mailers were to be advantaged further, new protections would have to be conceived and implemented. A flurry of activity began at this point to try to free up that critical volume of highly competitive mail for even more favorable treatment.

In May, 1991, the Institute of Public Administration, a private consulting firm paid by the USPS, was commissioned by the USPS Board of Governors to perform a study. The purpose was to study "the process by which prices are set for the variety of mail services, and the impacts of that process on the ability of the Postal Service to perform its mission effectively and efficiently, particularly with respect to criteria of fairness, flexibility, timeliness and simplicity."

When the USPS commissions a study to determine whether PRC rate review is impacting the performance of its mission, I have to wonder how the USPS understands its mission. No surprise, the USPS got what it paid for. The study, completed in October 1991, concluded that the Postal Service should be free to set its own prices, especially for competitive classes of mail, and that *competitors have too much influence on the ratemaking process.*

In January, 1992, a number of selected representatives from the USPS and Postal Rate Commission was organized into the Joint Task Force on Postal Rate making to propose ratemaking reform. In June, 1992 the Joint Task Force observed that "the Postal Service's letter mail monopoly gives rise to large economies of scale and scope which may give it a comparative advantage in some sectors of the marketplace." From that observation the Task Force submitted the questionable conclusion that, "The economy should be allowed the benefits of any such comparative advantages." Such an assertion appears contrary to the spirit of the Postal Reorganization Act, which describes the USPS as a public service first and foremost.

In April 1992, the USPS convened an ad hoc group of special customers and postal officials dubbed the Competitive Services Task Force. The co-chairmen were USPS Associate Postmaster General Edward E. Horgan and Advo CEO Robert Kamerschen. Serving on the Executive Steering Committee was Vincent Giuliano, Advo's Vice President of Government Relations. Even at that time it was widely reported that the USPS was studying the idea of a subclass for saturation third-class mailings. In a Competitive Services Task Force Meeting Summary, dated April 6-9, 1992, this Advo-driven task force suggested the following plan for increasing USPS volume:

> The Postal Service should review, immediately, its third-class mail rates and classification structure to determine its consistency with Postal Service Strategic Business Plans to facilitate cost reductions, operational needs and market development. The Postal Service should address the concerns and recommendations advanced by the General Accounting Office Report to the Congress as they specifically pertain to third class advertising mail.
>
> The Postal Service should reduce unit costs and adhere to its strategic business plan. Request that the USPS Board of Governors commit to give greater weight to market demand pricing when rates are proposed at the next omnibus rate increase. If necessary the Board of Governors should override the PRC.

1995 saw the culmination of this all-out effort to go after the advertising mail market. The result was a major reclassification case (MC95-1) in which the USPS eliminated "Third Class" from the postal vocabulary, replacing it with the new designation "Standard A Mail." Along with the proposal to overhaul mail classifications came the proposal (again) to reduce the rate for the highly competitive Advo-type saturation advertising.

The MC95-1 proposal was to reduce the pound rate for this kind of locally entered advertising, now called Standard A Mail, Enhanced Carrier Route, by 29.8%, from 56.8 cents to 39.9 cents per pound. The PRC, while granting the new ECR classification, did not buy the specific rate proposals. It instead recommended a rate for locally entered saturation advertising for this new subclass of 55.2 cents, a smaller reduction (2.8%), but a reduction nonetheless.

A speech made by Postmaster General Marvin Runyon, shortly after the results of the MC95- 1 case were in, demonstrated the predatory nature of the competitive drive of the USPS. Prior to the reclassification case, the Postal Service had made it abundantly clear that its prime targets were alternate delivery companies that through the early 1990s were gaining a small foothold in the delivery of Second Class subscriber magazines.

In the early 1990s, Time Warner started a company named Publishers Express (PubEx) to organize the private delivery of subscription magazines. At that time another company, Alternate Postal Delivery (APD) of Grand Rapids, Michigan, had demonstrated the feasibility of delivering subscription magazines, and had developed delivery capability in a number of major markets. With the addition of Publishers Express, by 1994 more than 80 markets were being served by either APD or PubEx affiliates, most of which were members of AAPS. The fact that the volumes delivered outside the mail were extremely small did not stop the Postal Service's search and destroy mission.

The USPS proposal in MC95-1 would have split regular rate periodicals into two subclasses, producing rate reductions for favored large magazine publishers (those whose density made them prospects for APD and PubEx) at the expense of large rate increases for small magazines that did not produce the density to make alternate delivery viable for them.

Although the Rate Commission rejected this aspect of reclassification, it did order rate decreases for the mass circulation periodicals, leading to the abandonment of alternate delivery by several major magazine publishers. As a result, Publishers Express announced in mid-February, 1996, that it would cease operations. Just days later, on February 20, Postmaster General Marvin Runyon, in a speech to the NAPUS Leadership Conference in Washington, DC addressed the demise of Publishers Express with unmistakable glee:

> I would like to close with a story that tells it all. Remember the alternate delivery company called Publishers Express? They came on the scene a few years back with a lot of fanfare and tough talk. They said they were going to deliver magazines and advertisements faster and cheaper than us. Eleven days ago, they quietly went out of business. They said that they were no longer needed. They had no more customers. We ran them out of business, by improving service and keeping costs low!
>
> I can't say that I am sorry to see them go. But they taught us two valuable lessons. First, if we don't do our jobs, somebody else will. And, second, when we get our act together, we can be one hell of a competitor.

Certainly, that doesn't "tell it all." Actions say it all - not speeches. Those actions say loudly and clearly that the Postal Service is intent on manipulating rates in such a way as to lower rates for competitive mail and increase rates for mail that has no competitive options. It would be comic, if it were not so serious, that when the Postal Service succeeds by creative pricing in driving a competitor out of business, the PMG publicly seizes the credit - chalking it up to "improving service and keeping costs low." I wasn't there, but I wonder if he delivered that line with a straight face.

I wonder if he cared about the jobs he "ran out," and about the investment by small companies in magazine delivery that the Postal Service wiped out. Apparently, people in our industry contributed to the millions of dollars of bonuses paid to postal executives.

By 1997 the USPS had its advertising mail reclassification, and it had achieved most of what it wanted by way of competitive "second class" (periodical) rates, but it did not yet have its desired rate advantage for saturation advertising. So just a little over a year after the conclusion of the reclassification case in early 1996, and in spite of a billion dollar plus surplus in FY 1997, the USPS requested another rate case, R97-1.

Most of the rates requested were nominal, single-digit increases. However, the proposal for the pound rate for saturation ECR mail called for a reduction down to 42 cents from the current 55.2 cents established by the Commission at the conclusion of MC95-1 just a year earlier. This would result in rate reductions of as much as 18% for highly competitive saturation advertising. It remains yet to be seen how the Commission will respond to still another request for a major decrease in the pound rate, the second such request in two years.

What does not remain to be seen is what the Postal Service would do if it could charge rates without prior review by the Commission. The new discounts added in R90-1, the flurry of USPS instigated supporting activity in 1991 and 1992, the major reclassification, MC95-1, and the recent request again for a huge reduction in R97-1 all demonstrate that the Postal Service is serious about reducing rates for this highly competitive kind of mail, and it will go to extreme lengths to accomplish that goal.

Below is a chart of the rates requested by the US Postal Service in rate cases from 1990 to the present. This chart graphically demonstrates the level to which the Postal Service believes rates for highly competitive saturation advertising should fall.

	Existing		**USPS Proposed**		**PRC Decision**	
	piece	**pound**	**piece**	**pound**	**piece**	**pound**
R90-1	10.1	48.0	9.1	43.3 (-9.8%)	10.5	49.6 (+3.3%)
MC95-1	12.0	56.8	11.2	39.9 (-29.8%)	11.4	55.2 (-2.8%)
R97-1	11.4	55.2	11.8	42.0 (-23.9%)	pending	

The above chart excludes the 1994 rate case. In R94-1 the USPS did not propose individual rates as it normally would. Instead, it proposed an across-the-board increase of 10.3% for all rates. The Commission recommended an increase for third class saturation advertising of +14% instead, which applied to both pound rate and piece rate. The USPS proposal was designed to minimize the importance of the 1994 rate increases in anticipation of the rate proposals being prepared for the reclassification case (MC95-1).

The only conclusion one can draw from this 15 year crusade on the part of the Postal Service, and the USPS rate proposals over the past seven years, is that, if given the chance, *the USPS will reduce the rate for highly competitive saturation advertising to the greatest extent allowed, and for the maximum competitive advantage. By its own actions, the USPS has repeatedly demonstrated that it believes this highly competitive rate to be 15% to 25% too high currently.*

If it were not for the Postal Rate Commission, these rates today would be substantially lower than they are. Much of the alternate delivery industry, which today provides income for hundreds of thousands of management and carrier personnel, would be out of business. And a delivery option for local advertisers who might not want to be stuffed inside a Kmart brochure would be lost. *And the vast majority of items in the average American US mailbox would consist of saturation advertising pieces.*

IV. The Effects Of Reform In A Less Favorable Economic Climate

One might argue that, even if we assume that the USPS will, without any question, lower the highly competitive ECR pound rate each year by 2%, a 2% decrease is not going to be the end of the world for any competitor. And certainly I would agree that death would not be instantaneous. But it would be no less certain.

Currently we are enjoying an economy characterized by steady growth and a low inflation rate in the 2% to 3% annual range. If the USPS were to lower the ECR pound rate 2% each year, competitors would see a real reduction of 4% to 5% the first year. The second year they would see another reduction of 4% to 5%, and so on. While inflation, albeit low inflation, pressures them to increase prices 2% to 3% per year to hold their margins, USPS delivered competitors would be handed regular *decreases* instead.

At this rate, alternate delivery would become unprofitable in three to six years, and alternate delivery companies one-by-one would have to close their doors as customers opt for lower cost solo mail or shared mail alternatives. After sjx years alternate delivery competitors would have seen their competitor, the USPS, reduce prices by a compounded 30% in real dollars.

That's the best case scenario. But suppose that, like in the late 1970s, there is double-digit inflation. Assuming postal reform is not going to be re-visited every five years, the 2% annual reduction will be around for a long time. Suppose the inflation rate rises to 8%. I believe it would be safe to assume, based upon recent history, that the inflation rate will fluctuate - the current low rate is not likely to last indefinitely.

Any USPS rate reduction of 2%, coupled with an inflation rate of 8%, would result in a real reduction of 10% per year. What safety mechanism exists to prevent such a pricing decision from putting a whole industry out of business? And of what value is a PRC review after the fact, once the competition is dead?

If the Postal Service is given the ability to implement a 2% reduction without any justification, the result will be the elimination of alternate delivery competition. It will depend on the inflation rate just how fast that happens.

V. Conclusion

I would urge the House Postal Service Subcommittee to reconsider the postal reform legislation as it presently exists. While the Association of Alternate Postal Systems is not supportive of any reform legislation, if there must be reform legislation, we would prefer the kind that allows us to remain in business.

There is no question that the US Postal Service is on a virtual crusade to take away the volumes of advertising that currently keep us in business. Any after-the-fact remedy or review is likely to be too late to repair the damage. The present system of prior PRC review, while not perfect, at least allows us to plead our cause before the damage can be inflicted.

We further urge the committee to eliminate the 2% reduction flexibility proposed in this legislation. That provision is our death sentence, whether by slow death or, in less healthy times, sudden death.

Sincerely,

Kenneth L. Bradstreet
Executive Director
Association of Alternate Postal Systems

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March 26, 1998

Honorable John McHugh
United States Congress
2157 Rayburn Office Building
Washington, D.C. 20515-6143

Re: Written comments on proposed revisions to H.R. 22 - overhauling the laws that govern the U.S. Postal Service.

Dear Congressman McHugh:

Less than four years ago, the private delivery industry delivered over 10% of the nation's magazines to home subscribers.

As the amount continued to grow, magazines returning to the postal steam thus became a mission for PMG Marvin Runyon. Although neither chartered or empowered to compete with public firms, the Post Office has, by design, managed to regain all of the magazines they once had, and they did it with what borders upon "predator pricing".

We can now add to the 1996 demise of Publisher's Express, that of Alternate Postal Delivery, Inc., both firms that once brokered magazine delivery to private delivery. One is gone, and the other has been forced to shut down that portion of their operation.

Currently the Private Express statutes protect 82% of the Postal Service's revenue from competition. So, what chance do private delivery firms have when the Post Office targets and reclaims a portion of the scant 18% left available?

By giving the postal administration something of a free competitive rein, we can see by this latest development that "ensuring adequate revenue" comes again at the expense of free enterprise.

Association of Alternate Postal Systems, Inc. . P. 0. Box 1331 . Gaylord, MI 49735 . (517) 731-2988

I'm enclosing an open letter to our nation's magazine publishers that will soon publish in our association's newsletter.

It portrays more clearly these unsettling recent events and I hope it will provide you with at least a yellow caution light as discussions escalate regarding H.R. 22.

Before Postal Reform laws can be crafted *to not* endanger the private delivery industry any further, Congress must first address the restraint imposed by our archaic Private Express statutes. Most notably as they apply to all forms of advertising mail and publications.

The basic purpose of the letter mail monopoly hasn't changed in more than 200 years. Does Congress really think our forefathers envisioned protection from private competition for address specific automobile and siding brochures?

Sincerely,

John S. White
Immediate Past President
Association of Alternate Postal Systems, Inc.

Encl: as stated

MAGAZINES RECONCILIATION WITH THE POST OFFICE:

HOW SOON THEY FORGET

by John S. White
Member, AAPS Postal Affairs
Immediate Past President of AAPS

America's most prominent magazine publishers, a fixture in the alternate delivery industry for the past decade, have left the industry completely.

A process of erosion over the past few years finally took its toll, leaving iiie last remaining broker of magazines, Alternate Postal Delivery, Inc., no choice but to "close that chapter" of their business.

Since I have been a very vocal proponent for magazines in the private delivery sector, I would like to add an epilogue.

But first a short story.

As a young boy, I remember my Grandfather and I planting a small, native pecan tree in his backyard.

The tree grew each year and as it did so, we soon found ourselves sitting beneath the shade of it, protected from the heat of the Oklahoma sun.

In the fall, we would round up the pecans and pluck the sweet meats from the center, enjoying the fruits of our labor.

Even though early frosts sometimes rendered the tree barren until the next fall, never once did we forget why we planted it in the first place.

The point is, Alternate Delivery provided both fruit and shade for America's magazine publishers. So why then are they returning all their deliveries to the postal stream?

Based in part on competitive pressures, did we not just finish an unprecedented era of near steady postal rates throughout the entire decade of the 90's?

Have each of our magazine publishers forgotten that Marvin Runyon took the quick fix by slashing jobs when he inherited a postal service that was stuck in mud up to its axles, and facing increasing competition from the private business sector?

Even after giving Mr. Runyon credit for delivering the Post Office from that of a bureaucratic agency to a more competitive, business-like organization, it still leaves the fact that rates are once again on the rise.

There's no reason for this latest rate increase trend to quit either. After all, they've eliminated yet another area of their competition.

With alternate delivery effectively tossed aside, the post office can now take direct aim at what it truly fears most - electronic mail and information delivery.

The reason they now need rate increases after three years in a row of record profits, is to protect the expected losses this latest revolution will bring to the mail stream.

So, back to my original question to the national magazine publishers - fruit or shade? Why did you plant your tree in alternate delivery to begin with?

The answer is - both. By introducing a competitive factor into the equation, the post office's monopoly was forced to resort to more drastic measures to keep rates in check.

If you really don't think the investment into alternate delivery bore any fruit in the 90's then compare: your cost of a continued presence in alternate delivery to that of what ongoing rate increases would have been (and will be).

The practice of placing a giant governmental agency (The Post Office) into competition with the private sector (Alternate Delivery) has once again had the effect of a ravenous whale let loose among a bay full of defenseless seals.

It's amazing, but our industry will manage and uitimateiy survive. The focus should be on those who truly may not. The now captive users of the mail stream - the magazine publishers.

My Granddad never chopped down that shade tree on the sole basis that once in a while it didn't produce pecans. Think about it.